

Uva Wellassa University
Faculty of Management



Degree of Bachelor of Business Management in Entrepreneurship and Management
THIRD YEAR SECOND SEMESTER EXAMINATION – SEPTEMBER/OCTOBER 2015
EMG 461-2 Corporate Finance

Instructions to candidates:

No. of pages : Three (03)
No. of questions : Four (04) Essay
Time : Two (02) Hours
Marks allocated : 100 Marks
Answer **all** questions.

Index No:

01.

- i. Define Financial Management? (2 Marks)
 - ii. How does the modern financial manager differ from the traditional financial manager? (5 Marks)
 - iii. Briefly describe the three (03) major decision types in corporate finance? (9 Marks)
 - iv. Briefly explain the relationship among Agency Relationship, Agency Problem and Agency Costs with suitable examples. (9 Marks)
- (Total Marks - 25)

02.

- i. Giving the examples, define systematic and unsystematic risks. (6 Marks)
- ii. You are given following information.

State of economy	Probability of state	Return on A %	Return on B %
Recession	.30	-10	30
Normal	.40	25	20
Boom	.30	50	40

- a) What is the expected return for A? for B? (6 Marks)
- b) What is the Standard Deviation for A? for B? (6 Marks)
- c) Suppose you have Rs.200,000 in total. If you put Rs. 150,000 in stock A and the remainder in Stock B, what will be the expected return and standard deviation of your portfolio of investments? (7 Marks)

(Total Marks - 25)

03.

- i. What are the main characteristics of ordinary shares? (4 Marks)
- ii. Company debentures have a 15 percent coupon rate and a Rs.1000 face value. Interest is paid semi-annually and the debentures have 10 years to mature. If investors require a 17 percent yield, what is the bond's value? (7 Marks)
- iii. Sunset company's beta is 1.2. Assume the expected return on the market is 12% and the risk-free rate is 4%. Determine the expected return of Sunset's stocks using the capital asset pricing model. (7 Marks)
- iv. The next dividend for the Amazon Company will be Rs.6 per share. Investors require a 15% return on companies such as Amazon. Amazon's dividend increases by 8% every year. Based on the dividend growth model,

- a) What is the value of Sunset's stock today? (3 Marks)

- b) What is the stock value in 4 years? (4 Marks)

(Total Marks - 25)

04.

- i. Explain the relationship between firm value and cost of capital (5 Marks)
- ii. Rebel Company wants to calculate its weighted average cost of capital (WACC). The company's financial manager has collected the following information.

- The company's long-term bonds currently offer a yield to maturity of 9 percent
- The company's stock price is Rs.30 per share ($P_0 = \text{Rs.}30$)
- The company recently paid a dividend of Rs.2 per share. ($D_0 = \text{Rs.}2$)
- The dividend is expected to grow at a constant rate of 5 percent a year. ($g = 5\%$)
- The company pays a 10 percent flotation cost whenever it issues new common stocks. ($F = 10\%$)
- The company's target capital structure is 50 percent equity and 50 percent debt.
- The company's tax rate is 40 percent.
- The company anticipates issuing new common stock during the upcoming year.

You are required to: Calculate the WACC

(20 Marks)

(Total Marks - 25)

